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No. 08-417

Supreme Court, U.S.
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In The

Supreme Court of the United States

ROBERT KOWELL,

Petitioner,

vs.

JAMES H. DONELL, RECEIVER FOR J.T. WALLENBROCK & ASSOCIATES AND CITADEL CAPITAL MANAGEMENT GROUP, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION

PETER A. DAVIDSON
MOLDO DAVIDSON FRAIOLI SEROR & SESTANOVICH LLP
2029 Century Park East, 21st Floor
Los Angeles, California 90067
(310) 551-3100
Counsel for Respondent

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Are state law fraudulent transfers claims, arising out of a Ponzi scheme, preempted by the federal securities laws simply because the underlying Ponzi scheme investment was a security, where the investor/defendant did not commit securities fraud?

2. Did the Ninth Circuit correctly interpret and apply California Civil Code §§ 3439.04(a) and 3439.08(a) in finding that Petitioner, an investor in a Ponzi scheme, was the recipient of fraudulent transfers and, therefore, must repay the funds paid to Petitioner in excess of his investment?

3. Under California's version of the Uniform Fraudulent Transfer Act (California Civil Code § 3439 et seq.) do taxes, attorney's fees or other administrative costs incurred by a recipient of a fraudulent transfer constitute "reasonably equivalent value" to the transferor?

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I.

STATEMENT OF THE CASE

Petitioner's Statement of the Case is not correct. Petitioner starts out his explanation of the case stating: "This case involves a security investor and his elderly mother. . . ." As is evident by the caption of the petition, and in the Ninth Circuit's decision, Petitioner's mother is not a party and the reference to her is but a lame attempt to seek empathy from this Court.[1]

Additionally, throughout Petitioner's Statement of the Case, Petitioner refers to the action brought by Respondent against him as a "disgorgement" claim. This is incorrect and is an attempt to draw this Court's attention away from the fact that the claim asserted by Respondent was a state law, fraudulent transfer claim, based on California's version of the Uniform Fraudulent Act, California Civil Code § 3439 et seq. It was not some type of equitable disgorgement motion or action where federal common law might apply. See example, *SEC v. Ross*, 504 F.3d 1130 (9th Cir. 2007).

Because the Ninth Circuit's decision is based on its interpretation of California statutory law, this is not the type of case generally reviewable by this Court. It is precisely because of this that Petitioner

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[1] Respondent sued Edna Kowell in a separate lawsuit, obtained judgment against he and she then settled. She was never a party to the case below.

makes sweeping, inapplicable, general assertions as to why this Court should grant review. The issues involved have nothing to do with "the recent bail-outs", "the recent Wall Street disaster" or "current market conditions". Similarly, this case has nothing to do with a lack of consistency in statutes of limitation; whether federal common law should override state established statutes of limitation; or any choice of law problems, because this case involves California residents, all the parties' actions took place in California, Petitioner was sued in California, and the district court and Ninth Circuit correctly applied California law.

Petitioner invested in a Ponzi scheme that defrauded approximately 6,000 mostly elderly investors of over $200 million. Petitioner not only got back his principal investment, but received a "profit" on his investment. Petitioner, a California resident, was sued by Respondent,[2] a receiver appointed by the district court sitting in Los Angeles, to recover the false "profit" paid to Petitioner (the payment in excess of his investment) so funds would be available to pay the claims asserted against the entities under the Receiver's control. Respondent sued Petitioner on the basis that the payments made to Petitioner in excess of his investment constitute fraudulent transfers under California law.

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[2] Respondent is also a California resident.

Although Petitioner received a "profit" of approximately $50,000.00 on his investment in the Ponzi scheme, because of the passage of time and the applicable statute of limitation, Respondent only sought judgment against Petitioner for $26,396.10 plus prejudgment interest (the fraudulent transfers paid to Petitioner inside the applicable four (4) year statute of limitation).

Based on Petitioner's answers to interrogatories, in which he admitted he made money on his investment and paid taxes on approximately $50,000.00 of profit, Respondent filed a motion for summary judgment.

In opposing summary judgment, Petitioner did not controvert that he had invested $22,859.92 in the Ponzi scheme and received back $73,290.70; nor did he controvert that he received $50,431.78 more than his investment. Instead, Petitioner contended, as he did on appeal below and now before this Court, that Respondent was precluded from suing him on a fraudulent transfer theory because the underlying investment involved securities (promissory notes). Petitioner asserts that because the Ponzi scheme investment was a security, Respondent could only sue him for securities fraud, despite the fact that he did not commit securities fraud. That argument was rejected by the district court and by the Ninth Circuit.

The only reason Petitioner asserts that Respondent should not be able to sue him on a state law

fraudulent transfer theory and, instead, must sue him for securities fraud is because Petitioner wants to argue that the statute of limitations applicable for securities fraud, which he incorrectly asserts is one year, should be applied in this case, rather than the four year statute of limitations applicable to fraudulent transfers under California law.

Petitioner also argued below, and now once again before this Court, that in determining his liability under California's fraudulent transfer statute, Petitioner should be given credit for taxes he purportedly paid on the "profit" he received from the Ponzi scheme and should also be entitled to a credit or offset for his own attorney's fees *in defending* the fraudulent transfer action. Like in the courts below, Petitioner cites no authority entitling him to such offsets in a fraudulent transfer action. The Ninth Circuit set forth a number of reasons why such offsets would not be appropriate, which reasons are consistent with California case law and other decisions prohibiting such offsets.

II.

REASONS FOR DENYING THIS PETITION.

The Ninth Circuit's decision does not conflict with the decision of any Court of Appeals or of this Court. The decision does not implicate any federal question. The decision is based on the Ninth Circuit's interpretation and application of California law. Petitioner, therefore, has not carried his burden of

demonstrating any "compelling reason for the Petition to be granted." See Sup. Ct. R. 10.

A. There Is No Conflict In The Circuits.

No conflict in the circuits exist with regard to the issues raised in the petition. Petitioner cites no conflicting decisions of any court of appeal. Indeed, other courts of appeal decisions are consistent with the decision of the Ninth Circuit. See for example, *Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995), *cert. denied*, 516 U.S. 1028, 116 S.Ct. 673, 133 L.Ed.2d 622; *Warfield v. Byron*, 436 F.3d 551 (5th Cir. 2006).

B. The Ninth Circuit's Decision Is Based On California Law.

The decision of the Ninth Circuit is based on its interpretation of California Civil Code § 3439 et seq.; California's version of the Uniform Fraudulent Transfer Act. As such, the decision is not one that this Court would generally review because this Court generally defers to a court of appeal's interpretation of state law. *Pembaur v. Cincinnati*, 475 U.S. 469, 484, n. 13, 106 S.Ct. 1292, 1301, n. 13 (1986) ["We generally accord great deference to the interpretation and application of state law by the courts of appeals"]; *McMillan v. Monroe County Alabama*, 520 U.S. 781, 786-87, 117 S.Ct. 1734, 1737 (1997).

C. The Underlying Case Did Not Involve Any Federal Questions.

Contrary to Petitioner's assertion, the case brought by Respondent against Petitioner under California's Uniform Fraudulent Transfer Act did not involve any federal questions. Because there is no other basis for this Court granting certiorari, Petitioner has attempted to invent federal or constitutional issues where none exist.

Petitioner first argues that due process requires uniformity of state fraudulent transfer laws so that possible defendants know what claims might be asserted against them. Petitioner, however, does not assert that his due process rights were violated because, contrary to Petitioner's argument, he did not have to guess about what law might be applied or the applicable statute of limitations because there was no choice of law issue involved in this case. Petitioner was a California resident, Respondent was a California resident, all the actions involved took place in California, the district court was sitting in California and the district court and the Court of Appeals correctly applied California law.

The fact that some states have adopted the Uniform Fraudulent Transfer Act as proposed, some have slightly modified it, and some have not adopted it does not create *Erie* Doctrine questions, especially in this case where the parties and the actions all took place in California and only California law could apply. Because there is no conflict of law issue

involved in this case, there is no reason why, as Petitioner asserts, federal common law would or should displace state law. The law review articles cited by Petitioner, which constitute the only authority cited by Petitioner on this issue, make clear that they are discussing "extraordinary conflict of law issues . . . in disgorgement proceedings where transfers have been made to investors across state lines as part of a multi-state Ponzi scheme." *The Application of Federal Common Law to Overcome Conflicting State Laws in the Supplement Disgorgement Proceedings of an SEC Appointed Receiver*, Seton Hall Circuit Review, Vol. 3, No. 1, p. 34 (2006). That is not the case here. Further, any attempt to have federal common law usurp state statutory law itself raises unnecessary constitutional problems. As the Seton Hall article *supra* notes:

> "It is well recognized that the application of federal common law implicates major constitutional concerns. Indeed, a federal court exercising authority to implement common law does "engage in interstitial 'lawmaking,' as part of the process of interpreting positive law" raising serious separation of powers issues. Federal judge-made law may also have the consequence of impeding upon the autonomy and independence of states by preempting state law signaling federalism concerns."

Id. at 35.

Respondent's preemption argument is similarly meritless. Petitioner cites no cases holding that the federal securities laws preempt state law fraudulent transfer laws simply because the underlying investment was a security. Petitioner cites this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991). Petitioner, however, not only acknowledges that *Lampf* was abrogated by Congress, but it has no applicability to this case nor do the other cases Petitioner relies on. This Court's decision in *Lampf* concerned what the statute of limitations should be for an action brought under section 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5. It does not purport to limit causes of action that can be brought under state law, especially causes of action which are not based on securities fraud but assert other state law claims. This Court did not even mention the issue.

Livid Holdings Ltd. v. Solomon Smith Barney, Inc., 416 F.3d 940 (9th Cir. 2005), which Petitioner also cites is also inapplicable. In that case the Ninth Circuit reversed the district court's dismissal of the plaintiff's state securities fraud and state tort violations. The plaintiff was allowed to pursue its federal securities fraud, state securities fraud and state tort claims in the same lawsuit. The Ninth Circuit further held that Rule 10b-5, promulgated under section 10(b), does not contain its own statute of limitations and while this Court in *Lampf*, *supra*, held that 10b-5 claims must be brought within one year after discovery or three years after the violation,

when Congress passed the Sarbanes-Oxley Act in 2002, it extended the statute of limitations for 10b-5 claims to two years after discovery of the facts constituting the violation or five years after such violations. There is no one year statute of limitations for securities fraud violations as Petitioner has claimed.[3]

This is not a securities case. Respondent did not sue Petitioner for securities fraud, nor could he. There were no allegations that Petitioner in any way violated the securities laws. He simply invested in the Ponzi scheme. "The elements of a Rule 10b-5 claim are (1) a misrepresentation or omission of a material fact; (2) scienter; (3) causation; (4) reliance; and (5) damages." *Livid Holdings*, *supra*, at 946. Petitioner cites no cases supporting his argument that simply because the underlying investment in a Ponzi scheme was a security, a receiver or bankruptcy trustee cannot sue the investor to recover false profits he or she received by using the Uniform Fraudulent Transfer Act.

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[3] See 28 U.S.C. § 1658(b). The statute of limitations contained in 28 U.S.C. § 1658 only relates to "claims that involve 'fraud, deceit, manipulation or contrivance' in contravention of the 'securities laws' which it defines to include the Securities Act as well as the Exchange Act." *In re Worldcom, Inc. Securities Litigation*, 294 F.Supp.2d 431, 441 (S.D.N.Y. 2003), *reconsideration denied*, 308 F.Supp.2d 214 (S.D.N.Y. 2004). In *Worldcom* the Court found that "securities claims" that do not involve fraud or intentional misconduct by the defendant are not covered by the statute of limitations in 28 U.S.C. § 1658(b). *Id.* at 441-44.

The only reason Petitioner makes his preemption claim is so that he can argue the statute of limitations for an action under the securities laws should be applied to Respondent's fraudulent transfer action, rather than the statute of limitations specifically adopted by the California legislature for fraudulent transfer actions: California Civil Code § 3439.09.

Petitioner's final basis for this Court granting review is Petitioner's contention that he should have been allowed offsets for taxes he purportedly paid on the profit he received from his investment, his attorneys' fees *in defending* the fraudulent transfer action and other costs of acquiring or holding the Ponzi scheme investment. As he did in the courts below, Petitioner fails to cite any authority for such offsets in a fraudulent transfer action and cites no provisions of California's Uniform Fraudulent Transfer Act permitting such offsets.

The Ninth Circuit cited three (3) factors against allowing such offsets. Not only does Petitioner not provide any cogent argument as to why the Ninth Circuit was incorrect, but the Ninth Circuit's decision on this issue is consistent with California law, other states' decisions on the issue, and even decisions of this Court.

The main offset Petitioner seeks to assert is for the purported taxes he paid on the profit he received from his investment. California law has rejected such offsets. See *DePalma v. Westland Software Warehouse*, 225 Cal.App.3d 1534 (1990), where the

court of appeal held that tax consequences should not be considered as offsets in a breach of contract action and surveyed the law on the issue. The rule is equally applied in fixing damages in fraud restitution actions which, the Ninth Circuit noted, is the claim Petitioner has that allows him an offset for the principal amount of his investment in the Ponzi scheme. Absent that claim, Respondent would have been entitled to recover all the payments made to Petitioner. See, *Danzig v. Grynberg*, 161 Cal.App.3d 1128 (1984), *cert. denied*, 474 U.S. 819, 106 S.Ct. 67 (1985) [tax consequences are irrelevant to setting damages in fraud restitution actions]. The court in *DePalma*, *supra*, also cites with approval the Montana Supreme Court's decision in *Billings Clinic v. Peat Marwick Main Co.*, 244 Mont. 324 (1990) where the Montana Supreme Court rejected tax benefits offsets holding that "considering tax benefits as offsets would be unduly speculative." The court in *DePalma* concluded that "estimating tax consequences is not useful because it is speculative, time consuming, and confusing," *supra*. at 1541; the same basis relied on by the Ninth Circuit. Indeed, this Court has held that tax benefits should be ignored for purposes of a recessionary remedy. *Randall v. Loftsgaarden*, 478 U.S. 647, 106 S.Ct. 3143 (1986).

The Ninth Circuit also correctly points out that it would not be equitable to permit an offset because any offset would come at the expense of the other innocent Wallenbrock investors and to allow an offset for taxes would open the door for other offsets, which

Petitioner argues for, such as his attorneys' fees *in defending* the fraudulent transfer action and purported costs he incurred in acquiring his investment, such as interest he might have paid to acquire the funds to make the investment. Petitioner cites no authority that he is entitled to such offsets and hence no "compelling reason" for the petition to be granted, especially when there are no cases Petitioner can cite to which conflict with the Ninth Circuit's decision interpreting California law.

III.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

DATED: October 29, 2008

Respectfully submitted,

PETER A. DAVIDSON
MOLDO DAVIDSON FRAIOLI
SEROR & SESTANOVICH LLP
2029 Century Park East,
21st Floor
Los Angeles, CA 90067
(310) 551-3100
Counsel for Respondent